



TAX EXEMPT BONDS



FY 2005

TAX EXEMPT BONDS

WORK PLAN

Planning Guidelines

October 1, 2004

FY 2005 TEB WORK PLAN PLANNING GUIDELINES

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FY 2005

TEB PLANNING GUIDELINES

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Executive Summary

Tax Exempt Bonds

FY 2005 Implementing Guidelines

The work plan provides program guidance and direction to all TEB employees.

TEB Operating Priorities support the IRS's new Strategic Plan for FY 2005-09. The Strategic Plan outlines three strategic goals that guide the future direction of the agency:

- Improve Taxpayer Service;
- Enhance Enforcement of the Tax Law; and
- Modernize the IRS through its People, Processes and Technology.

In support of these goals, TEB has committed to the following Operating Priorities:

- Enhance enforcement of the tax law through execution of ongoing program and examination initiatives directed toward abusive transactions,
- Maintain partnerships with customer and stakeholder groups,
- Deliver on requests for voluntary closing agreements, and
- Maintain emphasis on conducting quality examinations through the continued development of a highly qualified and satisfied workforce.

Section I provides the specific program priorities and goals/objectives for the Customer Education & Outreach function.

Section II provides the specific program priorities and goals/objectives for TEB Compliance Services.

Operating Priorities

Field Operations (FO) will continue its focus on questionable bond transactions, concentrating efforts on executing on its enforcement efforts directed toward abusive transactions and participants in the tax-exempt bond community. It is expected that during FY 2005, TEB FO will spend additional resources to increase activities relating to arbitrage motivated and/or abusive transactions. FO will continue to utilize the IRC section 6700, tax promoter penalty, to target specific transaction participants and to refer unethical behavior by professionals to the Office of Professional Responsibility.

A high priority of TEB is to communicate effectively with the diverse membership of the municipal bond community. TEB will continue to develop partnerships with state and local government officials, regulatory agencies, industry, and national professional associations, as well as their state and local affiliates and members within each of our customer segments.

Outreach, Planning & Review (OPR) will continue with its primary responsibility for the negotiation and execution of voluntary closing agreements pursuant to the Tax Exempt Bond Voluntary Closing Agreement Program (TEB VCAP).

TEB will continue to train its workforce to ensure that employees have the skills necessary to execute on TEB's operating priorities. TEB intends to continue the build out of its specialty training programs to allow employees to focus on specialized areas of tax-exempt financing. TEB will continue our use of the employee survey to identify opportunities for improvements in employee satisfaction.

FY 2004 Accomplishments

TEB leadership is grateful for the support and business results of its talented workforce. During FY 2004, TEB closed 400 examinations, closed 51 voluntary closing agreement requests and delivered 60 outreach presentations to 5,207 customers. Examination cycle time was reduced by 44 days to 350 days. TEB delivered two new publications geared to the tax-exempt bond community. TEB achieved these dramatic results despite the continuing attrition of personnel in all areas of TEB.

These increased accomplishments also reflected well in the Survey2004 results. TEB overall satisfaction remained high with 80% rating their satisfaction as a 4 or 5 out of 5. TEB leadership is appreciative of the satisfaction TEB employees take in their work.

SECTION I

Customer Education and Outreach

Operating Priorities

The Operating Priorities included in the FY 2005 TE/GE Strategic Plan were included in both the GE Program Plan and the TEB Program Plan and used in formulating the TEB FY 2005 Work Plan are:

- Enhance enforcement of the tax law through execution of ongoing program and examination initiatives directed toward abusive transactions,
- Maintain partnerships with customer and stakeholder groups,
- Deliver on requests for voluntary closing agreements, and
- Maintain emphasis on conducting quality examinations through the continued development of a highly qualified and satisfied workforce.

Overview of Customer Education and Outreach

TEB will focus on providing the participants in the municipal bond industry with quality service to assist in understanding their tax responsibilities by continuing to conduct tailored educational programs focused on bond industry segments and monitoring non-compliance trends to design proactive education and outreach products for use by TEB customers.

Each TEB office should plan to fully support opportunities for education and outreach to customers in the various bond industry segments with a focus on assistance to smaller or infrequent issuers. Managers and their employees should participate in workshops, seminars, and meetings sponsored by bond industry groups and associations to effectively leverage limited TEB resources in educating customers about their filing requirements and operational responsibilities to ensure exemption throughout the life cycle of a bond issuance.

Outreach, Planning & Review

The TEB OPR staff is responsible for:

- Enhancing education and outreach programs with external stakeholders,
- Continuing to develop and issue specialized educational materials and publications to reduce burden on the various bond market segments,
- Expanding the TEB Internet and Intranet sites and otherwise leveraging technology to meet customer and FO needs,
- Identifying and implementing special projects,
- Implementing and evaluating project initiatives to determine compliance levels and to identify emerging trends and issues,
- Delivering training to TE/GE Customer Account Service (CAS) personnel for their use in answering TEB inquiries,
- Coordinating with Customer Account Services (CAS) return filings, taxpayer inquiries, revisions to Form 8038 series returns, and the anticipated increase in FY 2005 - 2007 return filings due to the IRC section 146 changes,
- Providing assistance, when requested, to the Director's staff and FO on administrative and technical matters, and

- Coordinating legislative proposals with internal and external offices and agencies, including the annual “Legislative Proposals” submission by IRS.

Field Operations

TEB, FO Staff is responsible for assisting in the delivery of outreach programs by participation in seminars/meetings and partnering with outside stakeholders.

Focus Group

The TEB Focus Group facilitates quality examinations and ensures that examinations are conducted in a timely and efficient manner and result in consistent treatment of issues raised nationwide. The Focus Group includes agent and manager representatives from the FO groups, OPR representatives, and representatives from Counsel and Appeals. The TEB Focus Group holds quarterly meetings and plans to conduct at least one visit to each Field Operations group and to OPR during FY 2005.

Performances Measures for CE&O

The following performance indicators will be used in FY 05 for assessing CE&O programs and activities:

Tax Exempt Bonds	FY 2004 Actual	FY 2005 Goal
Number of Outreach Events	60	40
Customers Reached	5,207	4,000

SECTION II

Compliance Services

Operating Priorities

The Operating Priorities included in the FY 2005 TE/GE Strategic Plan were included in both the GE Program Plan and the TEB Program Plan and used in formulating the TEB FY 2005 Work Plan are:

- Enhance enforcement of the tax law through execution of ongoing program and examination initiatives directed toward abusive transactions,
- Maintain partnerships with customer and stakeholder groups,
- Deliver on requests for voluntary closing agreements, and
- Maintain emphasis on conducting quality examinations through the continued development of a highly qualified and satisfied workforce.

Overview of Compliance Services

TEB will focus on identifying and correcting non-compliance, ensuring consistency and fairness in application of law, and resolving issues at the lowest possible level using appropriate resolution mechanisms.

TEB Field Operations is responsible for:

- Conducting examinations using standardized procedures and audit guidelines,
- Measuring the compliance level of market segments by conducting project initiatives and identifying emerging trends,
- Applying IRC section 6700 promoter penalties, where appropriate,
- Utilizing IRC section 150(b) as an alternative to taxing bondholders, where appropriate,
- Identifying best practices and recommending changes in procedures,
- Coordinating with other IRS functions, including the Office of Professional Responsibility and the Criminal Investigations Division, and
- Recommending classification of returns related to general examination program activity.

TEB Outreach Planning and Review Staff is responsible for:

- Coordinating the selection of examination cases, including referrals, and approval of general classification cases,
- Working VCAP submissions,
- Working Willful Neglect Determinations on late-filed returns,
- Establishing and closing of examination cases on the Audit Information Management System (AIMS),
- Maintaining and updating the third party contact database,
- Conducting mandatory review (technical advice requests and cases being forwarded to Appeals), and
- Assisting field personnel in the identification and development of complex and emerging technical issues.

For FY 2005, emphasis will continue to be placed on emerging areas of concern and continuing investigations into arbitrage motivated and/or abusive transactions. It is anticipated that examination FTE applied to arbitrage motivated and/or abusive transactions will continue to increase in FY 2005. Training activities will be conducted, as necessary, to ensure consistent and uniform issue development and resolution.

Audit Techniques

The audit techniques for conducting examination activities are field, office, and correspondence. The managers in FO are responsible for determining which audit technique is appropriate for a case based on the potential issues involved, the scope of the examination, and the most effective way to gather required information.

Abusive Bond Transactions

The primary priority of the TEB Compliance Program in FY2005 is to address abusive tax exempt bond transactions. Abusive bond transactions generally involve the diversion of arbitrage payable to the U.S. Treasury. The issuance of bonds for the primary purpose of diverting rebatable arbitrage remains TEB's highest compliance risk and enforcement focus. TEB will increase direct examination staff years allocated to abusive transactions and promoters. Managers will assign these transactions priority status and ensure penalties are applied when appropriate.

Examination Categories

For FY 2005, TEB resources will be focused as follows:

- Solid Waste Disposal Facilities
- Yield Burning
- Failure to Rollover Escrowed Securities to Zero Interest Rate State and Local Government Securities
- Loan Pools
- Tax and Revenue Anticipation Notes
- Use of Proceeds – Governmental Bonds – 8038-G Rebate
- Single Family Housing
- Multi-Family Housing
- Tax Promoter Penalties (Section 6700)
- Other financings under section 145
- Penalty in Lieu of Rebate
- Forms 8038 -T project
- Use of Proceeds III
- Federal Home Loan Bank federal guarantees

These focus areas and other examination categories will be identified for technical time and inventory tracking reporting purposes through particular Activity Codes for the type of return and specific project codes.

Coordination with Other Agencies

FO and OPR will continue coordination with other Federal, state and local government and quasi-governmental agencies to identify and/or timely resolve compliance issues.

Research Program

The TEB market segmentation is a systematic method to define the universe by conducting examinations of a sample of returns on a nationwide or geographic basis and reflecting results/conclusions from the samples in a profile of the applicable market segment. The objective of TEB market segmentation is to continually build information and knowledge through research samples on the compliance levels of various types of bond issuances in the exempt bond universe in order to direct compliance activities to areas of actual or suspected noncompliance.

An Arbitrage Rebate Compliance Initiative and a Penalty in Lieu of Rebate Compliance Initiative were conducted during FY 2004. A compliance initiative focusing on open market escrows will be initiated during FY 2005. Other market segment initiatives may be initiated in FY 2005 if emerging financing strategies or compliance trends warrant.

Voluntary Resolution Programs

OPR will work documents submitted as part of the tax-exempt bond voluntary closing agreement program (VCAP) (Notice 2001-60, 2001-40 I.R.B. 304) and other voluntary resolution programs (e.g., Rev. Proc. 97-15, 1997-1 C.B. 635). OPR will continue to develop and expand its voluntary compliance programs.

Willful Neglect Determinations

OPR will work returns forwarded by the Ogden Service Center to make a determination whether the reason submitted for requesting an extension of time to file in accordance with Revenue Procedure 2002-48 was due to willful neglect. OPR corresponds and makes phone contact with issuers to gather information to make this determination.

Compliance Support Function

The TEB OPR staff provides administrative and research support to the field compliance function. This support includes all AIMS activities, referral analysis and research, claims processing, inventory validation, and third-party contact data. The OPR staff also will research available database information to provide field agents supporting documentation and information regarding examinations.

Performances Measures for Compliance Services

The following performance indicators will be used in FY 05 for assessing compliance programs and activities:

Tax Exempt Bonds	FY 2004 Actual	FY 2005 Goal
Voluntary Closing Agreement Cases Closed	51	54
Examinations Closed	400	420
Examination Timeliness	350	328
Examination Quality	*	80%

* Examination quality was first measured in 2004, but meaningful numbers will not be available until FY 2005

ATTACHMENT I

TEB TRAINING COURSES

The following items are descriptions of TEB training courses:

RESEARCH TRAINING

Course 4237: RICS – Phase I

This training is a 5-day course (including training and travel time) based on the RICS Phase I Training Guide that covers RICS functionality for basic RICS users. The primary purpose of the training is to support the classification of TE/GE returns and TE/GE non-return units. This training is ideal for new TE/GE classifiers and other new RICS users.

Course 4256: RICS – Phase II

This training is a 5-day course (including training and travel time) based on the RICS Phase II Training Guide that covers RICS functionality for experienced RICS users. This training is for all experienced RICS users.

Course 5108: Introduction to Specialized Research Software

This training will teach participants how to use electronic software of a commercial tax service to research tax law, court cases, revenue rulings, finance industry publications, municipal bond information, and other tax related materials. The training provides advanced instruction and function-specific exercises.

TEB TECHNICAL TRAINING

Course 4207a: Discrepancy Adjustments

This training provides agents with the basic knowledge and skills necessary to propose discrepancy adjustments to taxpayers Forms 1040 and 1120 as a result of a TEB examination. This course is one week in length. Training will be scheduled when hiring dictates the need for the class.

Course 4232: Basic Tax Exempt Bond Training – Phase I

This training provides agents with the basic knowledge and skills necessary to conduct examinations of municipal financing arrangements. This course is three weeks in length. Training will be scheduled when hiring dictates the need for the class.

Course 4259a: Advanced Tax Exempt Bond Training – Phase II

This training provides agents with the advanced knowledge and skills necessary to conduct examinations of municipal financing arrangements. Topics include advance yield on bonds, yield on investments, allocation and accounting, reimbursements and refundings. This course is two weeks in length. Training will be scheduled when hiring dictates the need for the class.

Course 4259b: Advanced Tax Exempt Bond Training – Phase III

This training provides agents with more advanced knowledge and skills to conduct examinations of municipal financing arrangements. Topics include pooled financings, advanced arbitrage and rebate concepts such as hedge bonds, reissuance, advance refundings and financial products. This course is one week in length. Training will be scheduled when hiring dictates the need find for the class.

Course 4233: TEB Technical Field Conference (CPE)

This training will cover current technical and operational developments in the bond area. There will be discussions of significant issues under examination and techniques used to develop the issues. The length of training is 5 course days (including training and travel time). The targeted audience is all TEB Technical Employees.

Course 9682b: Improving Performance thru Data Driven Decision Making

This training will introduce a nine-step problem-solving model. Participants use a current business challenge to analyze and solve. This course is one week in length.

TEB SPECIAL EMPHASIS TRAINING**Course: Rebate Project Initiative**

This specialty training provides agents assigned rebate initiative cases and the manager responsible for the initiative with the knowledge of the structure and requirements of the rebate initiative. The course will consist of a review of assigned cases and discussion of techniques to develop the related issues. The training will be 24 hours.

Course: Student Loan Bond Project Initiative

This specialty training provides agents assigned student loan bond cases and the manager responsible for the initiative with the knowledge of the structure and requirements of student loan bonds. The course will consist of a review of assigned cases and discussion of techniques to develop the related issues. The training will be 24 hours.

Course: Rebate

This specialty course will provide agents training in the use of Excel spreadsheets to perform various calculations relating to arbitrage rebate, including computation of investment yield, valuation of investments, computation of rebate amount, yield reduction payment and various exceptions to the rebate requirement. The training will be 24 hours and be taught as part of a group meeting.

Course: Abusive Transactions Update

This specialty course provides agents training in developing examinations on potentially abusive transactions. The course will provide an update on recent developments in abusive transactions. The training will be 24 hours.

Course: TEB Compliance Overview

This course provides non-TEB personnel an update of TEB compliance activities and how TEB issues interact with other functions in TE/GE. The training will be 8 hours and will be offered when requested by other functions in TE/GE.

Course: TEB Technical Update

This course provides an update on technical issues in TEB to Service Center and Call Site personnel. The training highlights emerging issues in TEB and provides information to personnel dealing with pre-filing and post filing compliance.

Course: TEB SLGS Initiative

This specialty training provides agents assigned SLGS initiative cases and the manager responsible for the initiative with the knowledge of the structure and requirements of the SLGS initiative. The course will consist of a review of assigned cases and discussion of techniques to develop the related issues. The training will be 24 hours.

REPORT GENERATION SOFTWARE (RGS) TRAINING

Course 4207a: EP/EO RGS (NT) Discrepancy Adjustments Training – Full

This training will cover the technical and procedural aspects of discrepancy adjustments as well as the RGS training on using the new windows version of RGS software to perform discrepancy adjustments. The targeted audience and date to be held will be locally determined. The length of the training is 4 days (including training and travel time).

Course 4248: RGS Coordinators Training

This training provides the TEB Division RGS Coordinator with information concerning their responsibilities as division coordinator. One person from OPR or one from FO will attend this 16 hours course (including training and travel time).

TE/GE REPORTING AND ELECTRONIC EXAMINATION SYSTEM (TREES)

Course: TREES

This training provides an overview and hands on training on the use of TREES. The course will be offered before the rollout of the TREES system. The course will be 24 hours.

ATTACHMENT II

Tax Exempt Bonds Knowledge Sharing Groups

Tax Exempt Bonds (TEB) has designed a knowledge sharing process in response to a need identified by our employees. By encouraging employee involvement, TEB seeks to encourage creativity, strengthen the social aspects of our team and share individual knowledge more naturally.

The use of knowledge sharing groups allows an organization to tap the intellectual aspects of its employees to achieve its goals. The knowledge sharing process will expand the technical and administrative skills of the TEB workforce, both individually and collectively. The effort will focus on the transfer of technical knowledge between employees to improve not only employee and customer satisfaction, but business results, as well.

Possible results expected from the implementation of knowledge sharing groups include:

- Sharing of best practices
- Increased level of knowledge in TEB
- Development of the “TEB community”
- Professional development of each member of the TEB community
- Protection of legacy knowledge
- Mentoring

Purpose

TEB is implementing Knowledge Sharing Groups to help create an environment that fosters the diffusion of knowledge. This knowledge sharing effort has four goals:

- Encourage creativity. The creation of Knowledge Sharing Groups will promote an environment where individuals are challenged to tap their creativity as they strive to improve our products and services.
- Foster knowledge sharing. The Knowledge Sharing Groups will provide a vehicle for individuals with “expert” knowledge in a particular field to share their skills and knowledge with others. This process will also facilitate the transfer of institutional knowledge and encourage employee development.
- Strengthen social ties. TEB is a small organization with employees scattered throughout the country. The Knowledge Sharing Groups will improve opportunities for individuals to interact with peers throughout TEB. These opportunities will strengthen the social ties among the team members.
- Develop employees. Employees have expressed an interest in furthering their knowledge of various aspects of the tax law and administrative matters. The Knowledge Sharing Groups will be a tool these employees can use to acquire this knowledge.

Membership

TEB Knowledge Sharing Groups will be comprised of 2– 5 employees from TEB.

The group will strive to maintain a demographic balance in its membership. It will also include both employees who have prior knowledge of the topic and those that have an interest in obtaining and developing knowledge of the topic.

Participants should expect to commit a minimum of six (6) months to work with their knowledge sharing group. After the first six months, a participant may rotate out of the group or extend his/her commitment for the next six months.

On the average, a participant should expect to spend a minimum of eight (8) hours (and not more than twenty four (24) hours) a month working on knowledge sharing group activities.

TEB Knowledge Sharing Groups

TEB has initiated two Knowledge Sharing Groups. They are:

1. Technical Knowledge Sharing Group

The Technical Group is formed to share technical expertise garnered as a result of the queries from agents and tax law specialists. They will strive to enhance the technical abilities within TEB by not only sharing technical responses to queries but by also providing the legal analysis underlying the response.

2. Returns and Processing Knowledge Sharing Group

The Forms and Processing Group is formed to improved the quality of data reporting on tax exempt bond returns. The Group will recommend revisions and additions to returns to provide information necessary for reporting and compliance activities and to improve the processing of return information. Instructions to returns will be revised to assist to provide explanations necessary to customers to accurately report return information.

ATTACHMENT III

Workload Selection

TEB will continue to refine the workload selection criteria utilized in prior years. Workload selection will be monitored to ensure that key areas identified through TEB strategic initiatives, project initiatives, market segment risk assessment and focus groups are addressed, and that the actions being assigned represent the optimal approach to the identified issue. The Workload Selection Process described in this section will be the primary tool TEB uses to identify and prioritize workload in concert with its Annual Work Plan.

An effective Workload Selection Process should accomplish several key tasks. It should:

1. Generate work that addresses issues pertaining to non-compliance on a national level.
2. Be data driven, to the fullest extent possible.
3. Be consistent with the balanced measures created by TEB.
4. Ensure fair treatment of each taxpayer
5. Ensure adequate controls are in place in accordance with Servicewide work assignment and approval requirements.
6. Be flexible enough to accommodate Work Plan adjustments e.g., new legislation and court decisions.
7. Provide the TEB field group managers the flexibility they need to balance local concerns with national priorities.

The Workload Selection Process for FY 2005 incorporates information from several sources. All of these sources are necessary to ensure the Workload Selection Process is data driven, consistent with our balanced measures and reflective of our customers' needs. This approach will also ensure that TEB efficiently uses its enforcement resources. TEB products that have a direct impact on this Workload Selection Process include:

1. TEB Strategic Initiatives
2. TEB Compliance/Project Initiatives
3. TEB Market Segment Risk Assessment
4. FY 2005 Annual Workplan
5. TEB Balanced Measures
6. Findings from focus groups, other ad-hoc meetings and other customer communicated items that identify customer needs.

Compliance/ Project Initiatives

There are two primary methodologies used to initiate project initiative. They are:

1. Market Segment Compliance Measurement – This methodology includes the systemic selection of each market segment over a period of time to measure noncompliance of that segment or type of bond. For example, small issue manufacturing bonds and single family housing bonds could constitute separate market segments.

2. Emerging Issues – This methodology measures noncompliance by identifying cases based on the existence of a potential emerging or identified issue within the TEB return population. For example, pooled financings.

The annual Market Segment Risk Assessment report provides a description of the types of bond issues for which returns have been filed during a specific year – usually a year at least 5 years prior to the Workplan year. The bond returns are categorized by the type of bond issue. Each category or segment is assigned a compliance risk factor (high, medium or low). The comparison of the volume (number of returns filed and dollar amount of the total issues in a segment) from one year to the next can impact the risk factor assigned to the segment.

The FY 2005 Annual Work Plan will impact the Workload Selection Process in that it quantifies the amount of resources that will be expended on any given market segment. For example, the number of examinations is dependent upon the resources devoted to these various segments. Resource allocation decisions are made by the Director of TEB and will be consistent with the overall goals of the business plan.

The Balanced Measures are consistent with the overall outline of the IRS organizational measures:

- Employee Satisfaction
- Customer Satisfaction
- Business Results – Quality & Quantity

These three measures represent one of the levers of change for the successful modernization of the Internal Revenue Service. The actions undertaken in the Workload Selection Process will be consistent with these measures.

The purpose of this Workload Selection Process is to outline the methodology to identify and prioritize those returns or customers that warrant an examination. It will also identify and prioritize those customers who may be less compliant on a given national issue. The FY 2005 Annual Work Plan quantifies resource expenditures dedicated to the various initiatives.

This Workload Selection Process does not affect the ability of a Group Manager to request approval to generate compliance workload based on their knowledge of an issue that they believe requires immediate action. However, such requests must be directed to the Manager, OPR and approved by the Manager, OPR and Manager, FO and must be justified as to their importance as well as any negative impact on other work.

Methodology

The Workload Selection Process for FY 2005 will generate examination work for the five TEB field groups. Much of the casework will be derived from recommendations and potential compliance issues identified in TEB Strategic Initiatives, Compliance/Project Initiatives, the Market Segment Risk Assessment (see Attachment VIII) and Referrals (including I.R.C. section 6700 leads).

The following areas will be emphasized in the FY 2005 Workload Selection Plan:

Claims

All claims for refund filed through the Ogden Service Center are controlled on AIMS and forwarded to a TEB field group for processing. Some claims require taxpayer contact and others can be closed based on the information provided with the claim. The manager of the group processing a claim will send the closed claim case file to OPR. If the claim is allowed, OPR will forward the Manual Refund form for the case to Ogden for issuance of the refund. OPR will close the case on AIMS. Claim cases are priority cases.

Referrals/Information Items

TEB referrals come from many sources: the media, informants, other Operating Divisions, Appeals, etc. All TEB referrals and information items that are submitted for examination consideration, except certain IRC 6700 cases resulting from a lead, are routed to OPR for review and approval. OPR personnel research Information items on IDRS and RICS to provide relevant return filing information for the subject of the referral and information item.

To ensure unbiased selection of cases for examination, referrals must be approved by both the Manager OPR and the Manager FO (the Referral Committee) before assignment to a field group.

Three forms are prepared for each Referral: a TEB Referral, Information Reports and Information Items Record and a Tax-Exempt Bond Information Item Tracking Sheet. These forms become part of the examination case file. In addition, a copy of each form is retained in a Referral Log in OPR. The group manager completes the form during the case closing and a copy of the form is pulled during the closing of the case in OPR and associated with the copy in the Referral Log. The examination results are notated in the Log. The Logs are housed in OPR and provide a historical reference record of referred bond issues.

Promoter Penalty Cases

IRC 6700 of the Code imposes a penalty on any "person" who commits certain actions described in the Code section. For TEB purposes, the penalty applies to bond counsel, investment bankers and their counsel, issuers (and beneficiaries of "conduit bonds") and their counsel, financial advisors, feasibility consultants, engineers and engineers and other persons who engage in the activities described in the Code section. (Since the majority of the subjects of the TEB promoter examinations are not under the jurisdiction of the TEB Operating Division, TEB shares promoter data with other Operating Divisions to reduce possible jurisdiction issues.)

TEB identifies IRC 6700 leads by:

- a. Working cooperatively and coordinating, to the extent permitted under IRC 6103, with counterparts at the Securities and Exchange Commission (SEC); National Association

of Securities Dealers (NASD); Municipal Securities Rulemaking Board (MSRB); and, Offices of State auditors, etc.

- b. As part of its normal examination activities, TEB agents carefully reviewing the use, expenditure and investment of proceeds of the bond issue and what the various participants knew, or should have known, with regard to such use, expenditure or investment of bond proceeds. In those instances where abusive transactions are found TEB using existing databases or John Doe summonses determines whether there are similar transactions done by the same parties (repeat transactions).
- c. Monitoring industry materials and publications to identify new financial techniques and schemes.

TEB has taken steps to improve identification of promoters by recommending legislative changes needed to permit TEB and SEC, NASD, MSRB and state authorities to exchange information similar to the exchange of information between IRS and Department of Labor on examinations of employee plans. Currently, TEB must seek permission (execution of Form 8821) of local officials involved in the municipal bond issuance to share information with the municipal regulatory office of the SEC if the matter is non-criminal in nature.

Group managers will assign these cases priority status and ensure that penalties are applied when appropriate. TEB will use administrative tools, formal guidance and other issue resolution strategies to aggressively combat abusive transactions.

ATTACHMENT IV

Market Segment Risk Assessment

Risk assessment analysis supports TEB's continuing efforts toward completion of existing project initiatives and development and implementation of additional project initiatives. The assessment process also prioritizes potential areas of noncompliance. The initial TEB risk assessment analysis relying on Statistics of Income (SOI) data for tax years 1987-1995 was useful and revalidated. For FY 2005 the data is taken from 1999. Each type of bond issue is considered as a separate market segment and assigned a rating potential for noncompliance of low, medium or high risk. Future examination activities will be based on this analysis as well as staffing, available guidance and other relevant factors. For FY 2005, field personnel will be applied in such a manner as to ensure timely completion of existing projects and prompt action on emerging issues. In addition, TEB may initiate one or more new compliance initiatives after taking into account TEB's increasing activities relating to arbitrage motivated and/or abusive transactions.

The Tax Exempt Bond (TEB) function has broadly identified its bond population as either governmental or private activity bonds. Governmental bonds are issued and controlled by state and local authorities. Private activity bonds are issued by state and local authorities and allow a percentage of private business use and the involvement of private entities. Governmental and private activity bonds are issued as either new long or short term bond issues or refunding issues. New issues are bond issues the proceeds of which are used to finance the governmental purpose of the issue. On the other hand, refunding issues are bond issues the proceeds of which are used to prepay the prior issue that originally financed the project.

Bond issuers are required to file information returns (Forms 8038, 8038-G, 8038-GC) to provide identifying information about the bonds they issue. The Statistics of Income (SOI) function extracts data from these returns and provides a compilation (in the form of tables) of the data to OPR. TEB is relying on SOI data in its compliance risk analysis. In selecting bond issues for examination, it is prudent to select issues that were issued at least five years prior to the selection. The issuer is generally required to spend the proceeds within 3 years of the issue date and to make any rebate payment due to the US Treasury five years after the issue date of the bond issue. If the Service examines an issue that was issued less than 5 years before the selection date, the agent cannot determine whether the issuer has paid, or intends to pay, the rebate. Having said that, under certain circumstances, the Service will examine bond issues that were issued less than 5 years before the issue date. This occurs in instances where the Service is seeking to monitor compliance with specific sections of the Code and regulations, or, if there are emerging issues in the bond market which need to be currently addressed.

Forms 8038 and 8038-G include a section titled "Type of Issue" in which the bond issuer is required to identify the purpose or purposes for which the proceeds of the bond issue are expected to be used. TEB considers each type of bond issue as a separate market segment. The types of bonds listed on the Forms 8038 and 8038-G and treated as separate market segments. Analysis of the SOI information reflects that if the issuer indicates on Form 8038 or

8038-G multiple types of bonds issued as part of the issue by checking more than one "Type of Issue", SOI has counted each purpose separately for multi-purpose issuances.

ASSESSMENT OF COMPLIANCE RISKS BY MARKET SEGMENT

Summary

TEB has defined noncompliance as the improper use of the economic benefit provided by tax-exempt bonds. Cases of noncompliance have been developed through referrals from internal IRS offices, other federal agencies, informants or media sources, information gathering and compliance initiatives and regular classification of returns. TEB has made an estimate in terms of low, medium or high the potential for noncompliance for the types of bonds issued.

Governmental Bonds

Governmental bonds involve bond issues the proceeds of which are used to finance or refinance projects owned and operated by a state or local government, such as, courthouses, roads and schools. The use of proceeds by a governmental user as opposed to a non-governmental user lessens the potential for noncompliance. As a result, governmental bonds are generally considered low risk. However, governmental education bonds issued to finance public school construction expenditures were determined to have a medium risk of noncompliance. This is because the regulations provide a specific exception from the arbitrage rebate requirements with respect to bonds issued to finance public school construction if the amount of bonds issued meet certain special dollar limitations applicable only to public school construction bonds. Consequently, the potential for such bonds being issued to maximize arbitrage earnings rather than for valid governmental purposes is somewhat greater. This assessment has been confirmed by recent examination activity. In addition, examination activity has confirmed the increased compliance risk of Tax/Revenue Anticipation Notes (TRANS) and Bond Anticipation Notes (BANS) which were previously listed as having a Low Risk. The number of TRANS/BANS approximates 7,200 issues in the amount of \$33 billion dollars. These deals can involve large pool deals packaged and marketed to school districts. Possible compliance issues include reasonable expectations to spend the proceeds within the required timeframe and the issue of whether the TRANS/BANS were issued for a governmental purpose or merely to earn arbitrage. The compliance risk of TRANS/BANS has been changed to medium.

Private Activity Bonds

Private activity bonds are bonds where the financed facility is used by a private entity. The municipal issuer of the bonds either loans the proceeds to the private entity or leases or otherwise permits the private entity to use the bond-financed facility. Thus, the potential for noncompliance for private activity bonds is somewhat greater than that for governmental bonds. Under the private activity bond category, the solid waste disposal, housing, 501(c)(3) and small issue bonds were determined to have a high risk of noncompliance.

➤ High Risk:

Solid Waste: Solid waste issues were rated high based on preliminary results of an in - process compliance initiative. Based on current examination activity, there are indications that the industry has broadly interpreted the regulations applicable to solid waste bonds. Generally, the issue has been whether the facility financed with the proceeds of the bond issue collects and processes “solid waste.” The FY 2004 Workplan includes Project Code 113 to specifically identify these examinations.

Small Issue: Based on a compliance initiative completed in FY 2001, the small issue bonds segment was considered a priority item in both the FY 2000 and 2001 work plans. Small issue bonds may only be used to finance or refinance manufacturing facilities. In addition, specific capital expenditure rules apply to such issues. The compliance initiative determined that noncompliance is generally due to the private borrower of the proceeds of small issue bonds violating these two requirements. Small issue bonds were treated as program examinations in FY 2003; 12 returns were closed and 58 percent of those closures resulted in change cases. Returns continue to be selected for examination through regular classification. At this time, the risk level is determined to be high.

Housing: Housing bonds, which may be issued to finance single-family homes or multi-family housing projects, are determined to have a high risk of noncompliance. This is due to a number of reasons, including but not limited to, the high volume of the bond issues issued for such purposes, complex arbitrage rules applicable to single-family bonds that are subject to misinterpretation and abuse, and ownership of the multi-family projects by private developers. The FY 2005 Workplan includes Project Codes 124 and 125 to specifically identify these examinations.

501(c)(3): In part due to the substantial increase in the number of these issuances and the number of referrals involving 501(c)(3) bonds, this category of bonds has been determined to have a high risk of noncompliance. These financings are assigned Project Code 134 in the FY 2005 Workplan. Revenue agent training was held in this area during FY 2004.

➤ Medium Risk

Airport, sewage, student loan and hospitals/healthcare were determined to have a medium level of risk of noncompliance.

Airport: Airport bonds involve complex allocations of private uses resulting from a variety of users and are determined to have a medium risk of noncompliance.

Sewage:

As with solid waste bonds, the industry has broadly interpreted the regulations applicable to sewage bonds.

Student Loans: Student loan bonds involve complex arbitrage issues resulting from proceeds being recycled to make a number of loans to students and are determined to have medium risk of noncompliance.

Hospital/Healthcare: As a result of the changing healthcare industry, hospital systems have recently faced financial situations that have required them to either merge with other hospital

systems or privatize. Consequently, bonds issued to finance hospitals and related facilities are at medium risk for noncompliance.

➤ Low Risk:

Bonds issued to finance or refinance docks and wharves, enterprise zone, local electric facilities, gas and energy, water furnishing facilities, redevelopment, empowerment zone, and other non-government output facilities were determined to have a low risk of noncompliance. This is because the volume of bond issues issued to finance such facilities is relatively low and the facilities generally include considerable governmental involvement.

RELIABILITY OF ASSESSMENT OF COMPLIANCE RISKS BY MARKET SEGMENT

The information used to determine the above Compliance Risks is data from SOI analysis of tax exempt bond returns. The information is considered in conjunction with the outcome of prior year and current examinations to determine the compliance risk level of each segment.

ATTACHMENT V

TEB Form 5440

The attached Form 5440 is applicable for FY 2005.